

And the Number Is ...

Objectives

- Provide participants with a broad overview of the EFC calculation for dependent students.
- Introduce participants to professional judgment and its appropriate application.
- Share with participants some suggestions for counseling students and their families about EFC calculations and professional judgment.

Materials

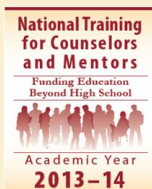
- PowerPoint presentation
- Overview of the EFC Formula Handout
- Appropriate Use of Professional Judgment Chart

Trainer Tips

- Due to the complexity of the topic, it may be easier to teach from the instructor's guide instead of the PowerPoint presentation.
- Avoid getting bogged down with multiple technical questions about EFC calculations and professional judgment. If a particular participant has numerous questions, it would be easier to address them one-on-one after the module.
- Feel free to share your own experiences explaining the EFC calculation and professional judgment to families.

And the Number Is ...

SLIDE 1



And the Number Is ...

Note to Instructor: This module provides a high level overview of need analysis and professional judgment. If a participant has a number of very specific questions, tell him or her you will answer his or her questions after the session to avoid becoming bogged down during the presentation.

I. Introduction

“Little black boxes” are interesting things. They can provide invaluable information, such as the cause of a plane crash. However, they can sometimes be confusing, especially if you don’t understand the process used to generate data. The calculation of the expected family contribution, or EFC, which is used to help determine a student’s eligibility for federal student aid, is a good example. Students and their families provide a wealth of information on the Free Application for Federal Student Aid, also known as the FAFSA, and the one of the key results is the EFC. But where in the world does this number come from?

A. Agenda

During this session, we will demystify the EFC. Specifically, we will talk about:

- How the EFC is calculated;
- The appropriate use of professional judgment; and
- The role of high school counselors and mentors in need analysis and professional judgment.

SLIDE 2

And the Number Is ...

Slide 2
NT4CM 2013-14

SLIDE 3

Agenda

- How the expected family contribution (EFC) is calculated
- Appropriate use of professional judgment
- Role of high school counselors and mentors in need analysis and professional judgment

Slide 3
NT4CM 2013-14

SLIDE 4

Importance of Learning about EFC Calculations and Professional Judgment

- Counselors and mentors are a critical source of information about the financial aid process
- Help in counseling students and families about applying for aid and understanding output

Slide 4
NT4CM 2013-14

B. Importance of Learning about EFC Calculations and Professional Judgment

At this point, you may be wondering why you need to learn about EFC calculations and professional judgment. After all, you aren't a financial aid administrator. However, you are a critical source of information about financial aid to your students. A basic understanding of how the U.S. Department of Education, also known as ED, calculates the EFC will help you answer questions as your students and their families complete the FAFSA. You'll understand why the form asks for the information it does.

As you know, many students and their families are in difficult situations, such as a loss of employment or high medical expenses that are not covered by insurance. The FAFSA does not provide a way for families to report these situations. A financial aid administrator may be able to recalculate a student's eligibility for financial aid using authority known as professional judgment. Understanding when professional judgment is a viable option will help you as you counsel students about applying for financial aid.

As you can see from our discussion, learning about EFC calculations and professional judgment can help you counsel students and their families about the financial aid process. Let's get started with EFC calculations.

II. Need Analysis

➔ *Before beginning this section, poll participants about their understanding of EFC calculations. Ask the following questions:*

- *Do you know how the EFC is calculated?*
- *Do you know what elements are included in the calculation?*
- *What is the student's and his or her family's responsibility in paying college expenses?*

SLIDE 5

Need Analysis

Need analysis has two parts:

- Estimating a student's college costs
- Calculating the EFC

Slide 5
NT4CM 2013-14

A. Need Analysis Basics

The calculation of the EFC is part of a process known as need analysis. As the term implies, this is how a student's need for financial aid is determined and is a system for allocating limited financial aid resources. Need analysis has two parts:

- Estimating a student's college costs; and
- Calculating the EFC, which is a gauge of a family's ability to pay for college expenses for a given year.

The difference between a student's costs and the EFC is his or her financial need.

Note to Instructor: You may want to point out to participants a student's college costs are known as the cost of attendance, which includes both direct and indirect expenses. More information about the cost of attendance is available in the Overview of Financial Aid module.

Historically, need analysis' guiding principles have been:

- Parents and students have the primary responsibility for meeting college costs.
- The distribution of financial aid resources should be based on the family's ability to pay—not willingness to pay.
- The assessment of a family's ability to pay should be independent of the amount of financial aid available and cost of attending college.
- There should be horizontal equity, also known as equity across the board, in the distribution of limited financial aid resources. That is, families in similar circumstances with similar resources should be expected to make similar contributions to college costs.

SLIDE 6

Need Analysis

Need analysis has two parts:

- Estimating a student's college costs
- Calculating the EFC

Slide 6
NT4CM 2013-14

SLIDE 7

Guiding Principles of Need Analysis

- There should be horizontal equity, also known as equity across the board, in the distribution of limited financial aid resources. That is, families in similar circumstances with similar resources should be expected to make similar contributions

Slide 7
NT4CM 2013-14

SLIDE 8

Guiding Principles of Need Analysis

- Families in different circumstances should be expected to make contributions appropriate to their financial resources. This is known as vertical equity and may sometimes be referred to as leveling the playing field

Slide 8

NT4CM 2013-14

SLIDE 9

Guiding Principles of Need Analysis

- The need analysis formula should provide a “snapshot” of the family’s financial circumstances at the time of application
- The need analysis results are a benchmark. As such, the final assessment of a family’s ability to contribute to the student’s college costs is subject to the professional judgment of the financial aid administrator

Slide 9

NT4CM 2013-14

- Families in different circumstances should be expected to make contributions appropriate to their financial resources. This is known as vertical equity and may sometimes be referred to as leveling the playing field.
- The need analysis formula should provide a “snapshot” of the family’s financial circumstances at the time of application.
- The need analysis results are a benchmark. As such, the final assessment of a family’s ability to contribute to the student’s college costs is subject to the professional judgment of the financial aid administrator.

The above guidelines give you an idea of some of the considerations which go into the determination of a student’s financial need. We will discuss the final principle, which addresses the professional judgment of the financial aid administrator, in more detail later in this session. For now, let’s turn our attention to the formula used to calculate the EFC.

B. The EFC Formula

The EFC formula is detailed in Title IV of the Higher Education Act of 1965, as amended, or HEA, which is the law that addresses much of the federal aid awarded to students pursuing some type of education beyond high school. In addition to setting out the formula to calculate student need, the HEA also details provisions of various federal aid programs, defines important terms, and explains the criteria students must meet in order to receive aid. When awarding federal student aid, financial aid administrators must determine a student’s need using the EFC formula.

As you can imagine, the formula is quite involved. We don’t have enough time today to review it “line by line,” but we will discuss

SLIDE 10

The EFC Formula

- Detailed in the Higher Education Act of 1965, as amended (HEA)
- Must be used to determine a student’s eligibility for federal student aid

Slide 10

NT4CM 2013-14

SLIDE 11

The EFC Formula

- Calculates a *family* contribution
 - Both the student and parents bear responsibility for paying for college
- Separate models for dependent and independent students
- Assumes enrollment for a full academic year (approximately 9 months)

Slide 11
NT4CM 2013-14

some key points and highlight issues that may be of particular concern to your students and their families.

Before we go over some important elements in the formula, there are a few things you should keep in mind. The formula calculates an expected *family* contribution—both the student and his or her family bear responsibility for paying for college. For many students, that means the EFC is comprised of both a parent and a student contribution. The formula also has separate models for dependent and independent students. Dependent students typically start college soon after high school and receive support from their parents. Independent students are students who are expected to pay for college without help from their parents. For our discussion, we will focus on the calculation of the EFC for dependent students. Finally, the EFC calculation assumes a student will be enrolled for a full academic year, which is approximately nine months. The financial aid administrator adjusts the EFC to reflect the student's actual enrollment, which could be a single term or include the summer in addition to the regular academic year.

Note to Instructor: *The criteria for a student to be considered independent for financial aid purposes are discussed in the Student Status module.*

Now that I have introduced you to need analysis, let's look at some basic elements of the EFC formula. We'll start with the treatment of income.

➔ *Direct participants to the handout, Overview of the EFC Formula, to use as a reference during the following discussion.*

SLIDE 12

EFC Formula: Income

Total income is the sum of:

- Taxable income (tax filers) or income earned from work (nonfilers)
- Untaxed income

Slide 12

NT4CM 2013 -14

SLIDE 13

EFC Formula: Untaxed Income

Untaxed income reported on the FAFSA:

- Payments to tax-deferred pension and savings plans (paid directly or withheld from earnings), including, but not limited to, amounts reported on W-2 forms
- IRA deductions and payments to self-employed SEP, SIMPLE, Keogh, and other qualified plans

Slide 13

NT4CM 2013 -14

SLIDE 14

EFC Formula: Untaxed Income

Untaxed income reported on the FAFSA:

- Child support received
- Tax-exempt interest income
- Untaxed portions of pensions
- Untaxed portions of IRA distributions, excluding rollovers
- Housing, food, and other living allowances paid to members of the military, clergy, and others

Slide 14

NT4CM 2013 -14

1. Income

As I mentioned a moment ago, the EFC is a gauge of a family's ability to pay for college expenses for a given year. One of the first steps in the formula is calculating a family's total income. For both the parent and student contributions, total income is the sum of taxed and untaxed income. The value of taxable income is easy to determine; it is the figure the student or parent reported on their federal tax return as adjusted gross income or AGI. If the applicant is not required to file a return, the formula looks at income earned from work.

Families may not realize what types of untaxed income must be reported on the FAFSA. They must include the following income on the form:

- Payments to tax-deferred pension and savings plans (paid directly or withheld from earnings), including, but not limited to, amounts reported on W-2 forms;
- IRA deductions and payments to self-employed SEP, SIMPLE, Keogh, and other qualified plans;
- Child support received;
- Tax-exempt interest income;
- Untaxed portions of IRA distributions, excluding rollovers;
- Untaxed portions of pensions;
- Housing, food, and other living allowances paid to members of the military, clergy, and others;
- Applicants must report cash payments or the cash value of benefits, but should not include the value of on-base military housing or the value of a basic military allowance for housing.

SLIDE 15

EFC Formula: Untaxed Income

Untaxed income reported on the FAFSA:

- Veteran's non-educational benefits
- Other untaxed income not included in the above categories, such as workers' compensation and private disability benefits
- Money received or paid on the student's behalf not reported elsewhere on the FAFSA

Slide 15

NT4CM 2013-14

- Veteran's non-educational benefits;
- Other untaxed income not included in the above categories, such as workers' compensation; and private disability benefits; and
- Money received or paid on the student's behalf not reported elsewhere on the FAFSA.

Note to Instructor: Point out to participants that the FAFSA provides guidance on reporting untaxed income, including where to find certain values on common federal tax forms.

SLIDE 16

EFC Formula: Additional Financial Information

- Education tax credits
- Child support paid
- Taxable earnings from need-based employment programs

Slide 16

NT4CM 2013-14

There is also additional financial information reported on the FAFSA which is subtracted from an applicant's total income. This includes:

- Education tax credits, such as the American Opportunity, Hope and Lifetime Learning Tax Credits;
- Child support paid;
- Taxable earnings from need-based employment programs such as Federal Work-Study;
- Grant and scholarship aid reported as part of AGI on the federal tax return;
- Taxable combat pay or special combat pay; and
- Earnings from work under a cooperative education program offered by a college.

SLIDE 17

EFC Formula: Additional Financial Information

- Grant and scholarship aid reported as part of adjusted gross income (AGI)
- Taxable combat pay or special combat pay
- Earnings from work under a cooperative education program offered by a college

Slide 17

NT4CM 2013-14

As you can see, an applicant's total income is more than just what he or she earns on the job. Now that we have a better understanding of the income considered in the formula, let's look at another major element, allowances.

SLIDE 18

EFC Formula: Allowances

- U.S. income tax paid
- State and other taxes
- Social Security taxes
- Income protection allowance
- Employment expense allowance

Slide 18

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2. Allowances

Allowances are items subtracted from a parent's or student's total income, and account for expenses which reduce the financial resources a family has available to pay for college expenses. The allowances included in the EFC formula are:

- U.S. income tax paid;
- State and other taxes;
- Social Security taxes;
- Income protection allowance; and
- Employment expenses.

The first allowance, U.S. income tax paid, is straightforward. Applicants should report the value from their tax returns. A common mistake is to report the amount withheld for taxes, which is reported on the W-2 form.

The next two allowances, state and other taxes and Social Security taxes, are calculated using tables. The calculation for state and other taxes looks at the applicant's state of legal residence and total income. The formula estimates Social Security taxes using a percentage of the student's or parent's income earned from work.

The purpose of the Income Protection Allowance, or IPA, is to account for a family's basic living expenses. Its value is determined based upon the size of the family and the number of family members who will be going to college. We'll talk about the IPA more later in this session.

SLIDE 19

EFC Formula: Available Income

Amount of income remaining after all applicable allowances have been subtracted

Slide 19
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The final allowance is for employment expenses. This allowance represents costs associated with employment such as transportation, meals away from home, and clothing. Eligibility for the allowance depends upon the makeup of the family and who is working. The amount of income remaining after the formula applies all applicable allowances is known as available income.

Note to Instructor: When calculating the student contribution, the formula also makes allowances for U.S. taxes paid, state and other taxes, and Social Security taxes. The IPA for dependent students is a set dollar amount. Dependent students are not eligible for the employment expenses allowance.

Now that we have looked at how the EFC formula treats income, let's turn our attention to another major component of the formula, assets. Available assets, in conjunction with income, measure a family's financial ability to pay college expenses.

3. Treatment of Assets

The FAFSA asks students and parents to report their assets, broken into the following three categories:

- Current balance of cash, savings, and checking accounts;
- Net worth of investments, including real estate but excluding the family's primary residence; and
- Net worth of businesses and investment farms.

Note to Instructor: Point out to participants that some families (generally those with lower income and who are eligible to file a simplified tax return, receive benefits from certain federal means-tested benefit programs, or include a dislocated worker), do not have their assets included in the EFC calculation.

SLIDE 20

EFC Formula: Assets

Reported on the FAFSA:

- Current balance of cash, savings, and checking accounts
- Net worth of investments, including real estate but excluding the family's primary residence
- Net worth of businesses and investment farms

Slide 20
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SLIDE 21

EFC Formula: Treatment of Assets

Two primary family assets not reported on the FAFSA:

- Family's primary residence
- Retirement plans

Slide 21
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For many families, the primary assets are the home and retirement accounts. As I just indicated, the value of the family's primary residence is not a reportable asset. Likewise, the value of retirement plans is not a reportable asset for FAFSA purposes. However, keep in mind that yearly contributions to tax-deferred pensions and savings plans must be included on the FAFSA as untaxed income.

SLIDE 22

EFC Formula: Assets

Parents' contribution from assets:

- Education Savings and Asset Protection Allowance subtracted from net worth
- Contribution is 12% of remaining assets

Slide 22
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The EFC formula looks at net worth, that is the current value minus debt, of the student's and parent's assets. Before determining the amount of parental assets available to pay for education beyond high school, the EFC formula applies an Education Savings and Asset Protection Allowance. The purpose of this allowance is to take into account the amount of money the parents should have saved for retirement and other expenses, based on the age of the older parent. After the allowance is subtracted from the total reportable assets, the remaining amount is assessed at twelve percent. The result is the amount of parental assets which should be available to help pay for the student's college expenses. For dependent students, there is no Education Savings and Asset Protection Allowance. The formula expects students to use twenty percent of their net worth to help pay their college expenses.

SLIDE 23

EFC Formula: Assets

Student's contribution from assets:

- 20% of net worth

Slide 23
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As our discussion has shown, the EFC is a combination of the family's income, the allowances applied against that income, and assets. Let's now take a look to see how these pieces come together in the EFC.

SLIDE 24

EFC Formula: Parents' Total Contribution

$$\begin{array}{r} \text{Parents' available income} \\ + \text{Parents' contribution from assets} \\ \hline = \text{Parents' adjusted available income} \end{array}$$

Slide 24

NT4CM 2013-14

SLIDE 25

EFC Formula: Parents' Total Contribution

Parents' total contribution from adjusted available income:

- Calculated using a table
 - Percentage of adjusted available income; or
 - Base amount plus percentage of adjusted available income

Slide 25

NT4CM 2013-14

SLIDE 26

EFC Formula: Parent Contribution

$$\frac{\text{Parents' total contribution from adjusted available income}}{\text{Number of family members in college}}$$

Slide 26

NT4CM 2013-14

SLIDE 27

EFC Formula: Student Contribution

$$\begin{array}{r} 50\% \text{ of student's available income} \\ + \text{Student's contribution from assets} \\ \hline \text{Student contribution} \end{array}$$

Slide 27

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SLIDE 28

EFC Formula: EFC

$$\begin{array}{r} \text{Parent contribution} \\ + \text{Student contribution} \\ \hline \text{Expected family contribution} \end{array}$$

Slide 28

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4. The EFC

At the beginning of our discussion of the EFC formula, I mentioned the EFC is comprised of two parts—a parent contribution and a student contribution. To calculate the parent contribution, the formula adds the parents' available income and the parents' contribution from assets. The total is known as adjusted available income. The parents' contribution from adjusted available income is calculated using a table. It is either a percentage of the adjusted available income or a base amount plus a percentage of the adjusted available income. If there will be more than one family member enrolled in postsecondary education, not counting the parent, the parent contribution is evenly divided between the students.

The student contribution is easier to calculate. The formula expects the student to spend fifty percent of his or her available income on educational expenses. To this amount, the formula adds the student's contribution from assets. Finally, the student's EFC is the sum of the parent contribution and the student contribution.

The student's EFC is the result of a complicated formula. Nobody expects you to explain it in great detail to your students and their families. However, there are a few highlights that can help you as you counsel families about the meaning of the EFC and its impact on a student's eligibility for federal student aid.

SLIDE 29

EFC Formula: Helpful Highlights

- Family bears some responsibility to pay for college
- Purpose of the income protection allowance
- Source of parent contribution
- EFC not necessarily what the family will pay out of pocket

Slide 29
NT4CM 2013-14

Note to Instructor: Before moving on to the next section, answer any questions about the EFC formula.

5. Helpful Highlights

At the beginning of the presentation, I shared some guiding principles of need analysis. The first principle is that the family—both parents and student—share the primary responsibility for funding a student's education beyond high school. This is why a family's ability to pay college costs is assessed before a financial aid office awards federal student aid. This principle is also clear in the calculation of the student's contribution, since the formula expects the student to use a higher percentage of his or her income and assets to pay for college than is expected of the parents. It may be necessary to remind families of their role in financing a student's education.

Many aspects of the EFC formula are confusing to families. One particularly confusing aspect is the income protection allowance or IPA we discussed earlier. You may want to point out the IPA is intended to represent *basic* living expenses and will not reflect a family's lifestyle choices. The calculation of the IPA is based on a standard table, and doesn't reflect regional differences in living expenses.

Another source of confusion arising from the EFC calculation is the source of the contribution. Many families assume there is an expectation that they will borrow against the value of their home or retirement plans to help pay for their student's college education. In other words, parents think the EFC is drawn from the value of their assets. In reality, the EFC for many students comes entirely from income. As you will remember from our discussion of assets, two primary assets of most families—the value of the home and retirement plans—are excluded from the EFC calculation. Additionally, the Education Savings and Asset Protection

Allowance is subtracted from the parents' net worth before the formula calculates a contribution from assets. As a result of these factors, the contribution from assets is often a negative number.

Finally, point out to your families that the EFC is not necessarily what they will pay out of pocket to their student's school. The student may have money from nonfederal sources, such as distributions from 529 college savings plans, to offset the amount due after the application of federal financial aid. It is also possible to borrow federal loans to replace the EFC.

Note to Instructor: *These borrowing options are discussed in more detail in the Overview of Financial Aid module.*

This concludes our discussion of calculating the EFC. We will now turn our attention to an issue that often comes up when a family learns the value of the EFC—how to take into account special or unusual circumstances when determining a student's eligibility for financial aid. A financial aid administrator considers a family's special circumstances by exercising professional judgment. What is professional judgment?

III. Professional Judgment

A. Professional Judgment Basics

Professional judgment is defined by the same law, the HEA, which details the calculation of the EFC. The statute defines professional judgment as:

“the authority of the financial aid administrator, on the basis of adequate documentation, to make adjustments on a case-by-case basis to the cost of attendance or the values of the data items required to calculate the expected student or parent contribution (or both) to allow for treatment of an individual eligible applicant

SLIDE 30

Professional Judgment: Definition

“the authority of the financial aid administrator, on the basis of adequate documentation, to make adjustments on a case-by-case basis to the cost of attendance or the values of the data items required to calculate the expected student or parent contribution (or both) to allow for treatment of an individual eligible applicant with special circumstances.”

Slide 30

NT4CM 2013-14

SLIDE 31

Professional Judgment: Basics

- Families cannot report special circumstances on the FAFSA
- Professional judgment exercised after the family files the FAFSA and completes verification (if required)
- Professional judgment exercised by the financial aid administrator

Slide 31

NT4CM 2013 -14

with special circumstances.”

I mentioned at the beginning of the presentation that the FAFSA does not provide a way for a family to indicate any unusual circumstances or special situations on the application. The purpose of professional judgment is to take these situations into account. The exercise of professional judgment generally occurs after the FAFSA is filed. If a family is selected for verification, this process must also be completed before any adjustments for a family’s unusual circumstances are done. Verification is a process by which a college confirms, or verifies, that the data a family provides on the FAFSA is accurate. It often requires families to submit documents to the financial aid office, such as W-2s and tax transcripts.

As the definition I read a moment ago implies, professional judgment is exercised by the financial aid administrator. Depending on the college, a single staff member or a committee could be assigned responsibility for this important process. You may find it helpful to learn how colleges and universities in your area approach the process.

➔ *Refer participants to the handout, Appropriate Use of Professional Judgment Chart, for the following discussion.*

B. Common Professional Judgment Situations

There are a number of situations where the exercise of professional judgment is possible. These include loss of income, unusually high medical expenses which are not covered by insurance, and elementary or secondary school tuition for younger children. In fact, the law provides a number of examples for which Congress believes the use of professional judgment is warranted.

SLIDE 32

Professional Judgment: Application

- Common professional judgment situations
- Situations where professional judgment is not appropriate

Slide 32

NT4CM 2013 -14

SLIDE 33

Professional Judgment: Process

- Varies from college to college
- Documentation
- Authority of the financial aid administrator

Slide 33
NT4CM 2013-14

C. Situations Where Professional Judgment is not Appropriate

As you can imagine, there are a number of situations where the use of professional judgment is not appropriate. Such situations are often a reflection of a family's lifestyle choices. Circumstances which do not justify the use of professional judgment include vacation expenses, tithing, and consumer debt.

Now that we have spent some time discussing some professional judgment basics, let's turn our attention to the professional judgment process.

D. Professional Judgment Process

The professional judgment process varies from college to college. Unlike other aspects of federal financial aid, the Department of Education cannot regulate professional judgment, so schools are free to structure the process in a way that best meets the needs of the institution. Keep in mind that it is up to the college whether or not it will exercise professional judgment, and for what situations. For example, one college will exercise professional judgment to take into account elementary school tuition for younger children while a nearby university does not consider such an expense as an appropriate use of its authority.

Regardless of how the process will vary from one college to another, some aspects of professional judgment will be the same regardless of the college attended. One of these consistencies is documentation. In order for the financial aid administrator to consider any possible adjustments to the information used to calculate the EFC, the family must be able to document its special circumstances. Some colleges will ask families to initiate their

request by submitting a signed statement describing their situation. Once staff reviews the personal statement, it will ask the family for supporting documentation, which can include items such as tax returns, pay stubs, and copies of medical bills. Other universities may make a special circumstances form available to families. The form will detail the required documentation to evaluate common situations, such as loss of income and medical bills not covered by insurance. It is important to note the financial aid office has a right to ask for the documentation it deems necessary to review a family's situation and to determine the appropriateness of any adjustments to the data used to calculate the student's EFC.

Another aspect of professional judgment which is consistent among colleges is the authority of the financial aid administrator. His or her decision is final, and cannot be appealed to the Department of Education. A family which disagrees with a decision should schedule an appointment with a staff member in the financial aid office. It is possible the family did not share all relevant information with the aid office, and additional documentation could impact the financial aid administrator's decision.

Note to Instructor: Before moving on to the role of high school counselors and mentors, answer any questions participants may have about professional judgment.

IV. Role of High School Counselors and Mentors

We have discussed quite a bit of information today about EFC calculations and professional judgment. Let's conclude our discussion with how this knowledge will help you counsel your students and their families about the financial aid application process.

SLIDE 34

Role of High School Counselors and Mentors

- Need analysis
 - Explain purpose of the EFC formula
 - Discuss confusing aspects of the formula
- Professional judgment
 - Explain the general concept
 - Explain appropriate use

Slide 34

NT4CM 2013–14

A. Need Analysis

A basic understanding of need analysis will allow you to share with families the purpose of the EFC formula, which is to gauge the family's ability to contribute towards the cost of the student's education beyond high school. Your knowledge will also allow you to discuss aspects of the formula which are confusing to families, such as the income protection allowance and the role assets play in the EFC.

B. Professional Judgment

What you learned today about professional judgment will also help you counsel students and their families. It is quite possible you will be aware of a family's special circumstances before anyone else. This will give you a chance to explain the general concept of professional judgment and stress the variation among different colleges' processes. You will also be able to give families an idea of the situations for which professional judgment is, and isn't, an appropriate option.

V. Conclusion

We have discussed some challenging topics during this session—need analysis and professional judgment. The primary goal of this module is to provide you with knowledge you can share with your students and families about how the EFC is calculated and professional judgment. This information should make it easier for families to understand and navigate the financial aid application process.

SLIDE 35

Questions



Slide 35

NT4CM 2013-14

SLIDE 36

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